

## Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 IO-13 ISO-00 AID-05 CIAE-00 COME-00

EB-07 FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06

SP-02 CIEP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

STR-04 CEA-01 L-03 H-02 PA-02 PRS-01 FEAE-00 OES-06

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R 071651Z SEP 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 5224

TREASURY DEPT WASHDC

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY DUBLIN

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

AMCONSUL BELFAST

AMCONSUL EDINBURGH

USMISSION EC BRUSSELS

USMISSION OECD PARIS

USDEL MTN GENEVA

UNCLAS SECTION 01 OF 03 LONDON 14064

DEPARTMENT PASS FRB

TREASURY FOR DONALD SYVRUD, OASIA

E.O. 11652: N/A

TAGS: EFIN, EGEN, UK

SUBJECT: NIESR SEES 3.5 PERCENT GROWTH THROUGH 1977

SUMMARY: INCREASED INVESTMENT AND RISING EXPORTS WILL EN-  
ABLE THE UK ECONOMY TO GROW AT AN AVERAGE ANNUAL RATE OF  
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3.5 PERCENT OVER THE NEXT 18 MONTHS ACCORDING TO THE LAT-

EST FORECAST PUBLISHED SEPTEMBER 3 BY THE RESPECTED NATIONAL INSTITUTE FOR ECONOMIC AND SOCIAL RESEARCH (NIESR). UNEMPLOYMENT IS EXPECTED TO REMAIN HIGH, DROPPING ONLY SLIGHTLY TO 1.2 MILLION BY THE END OF 1977, WHILE THE RISE IN RETAIL PRICES BETWEEN JUNE 1976 AND JUNE 1977 SHOULD BE ABOUT 10 PERCENT. NIESR RECOMMENDS INTRODUCING A DEGREE OF WAGE FLEXIBILITY IN ANY INCOMES POLICY PUT INTO PLACE WHEN THE CURRENT 4.5 PERCENT AGREEMENT EXPIRES NEXT AUGUST. THERE IS ALSO SUPPORT FOR CONTINUING THE PRESENT LINK BETWEEN WAGE RESTRAINT AND TAX CUTS AND A CALL FOR AN INTERNATIONAL EFFORT, PARTICULARLY AMONG EC MEMBERS, FOR COORDINATION OF NATIONAL ECONOMIC POLICIES WITH A VIEW TOWARD MINIMIZING TOTAL UNEMPLOYMENT AMONG THEM.

END SUMMARY

1. WHILE THE LATEST NIESR FORECAST IS SLIGHTLY MORE OPTIMISTIC THAN WAS THE PREVIOUS ONE IN MAY, UNEMPLOYMENT WILL REMAIN HIGHER FOR A LONGER PERIOD. THE CURRENT FORECAST IS BASED ON THE FOLLOWING PRINCIPAL ASSUMPTIONS:

- 1) UNCHANGED GOVERNMENT PLANS FOR TAXATION AND EXPENDITURE.
- 2) THE PRESENT DIFFERENTIAL BETWEEN US AND UK INTEREST RATES WILL BE MAINTAINED.
- 3) M3 WILL GROW AT 12 PERCENT PER ANNUM OVER THE PERIOD.
- 4) AVERAGE EARNINGS WILL RISE BY 9 PERCENT PER ANNUM THROUGH 1977.
- 5) THE RECENT PRICE CODE LIBERALIZATION WILL HAVE NO SIGNIFICANT IMPACT ON PRICES.
- 6) OFFICIAL FOREIGN EXCHANGE RESERVES WILL REMAIN BROADLY UNCHANGED WITH PUBLIC SECTOR BORROWING TOTALLING 4.5 BILLION DOLLARS IN 1976 AND 1.6 BILLION DOLLARS IN 1977.
- 7) WORLD TRADE VOLUME WILL RISE BY 10 PERCENT IN 1976 AND 9 PERCENT IN 1977.

2. USING A NEW AND EXPANDED ECONOMETRIC MODEL, NIESR PROJECTS THE FOLLOWING PERCENTAGE CHANGES IN THE MAJOR ECONOMIC AGGREGATES:

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PERSONAL UNEMPLOY-

	REAL GDP	DISPOSABLE	MENT (S.A.)	MONEY SUPPLY
	(PERCENT	INCOME (PER	FOURTH	(M3, PER
	CHANGE,	CENT CHANGE,	QUARTER.	CENT CHANGE,
	YEAR/YEAR)	YEAR/YEAR)	MILLION)	END-YEAR)
1975	-1.6	-0.1	1.1	7.7
1976	3.3	-1.1	1.3	10.0
1977	3.6	-0.9	L.2	10.9

	CURRENT	EFFECTIVE	PUBLIC SECTOR
	ACCOUNT	EXCHANGE	BORROWING
	CONSUMER	DEFICIT	RATE (FOURTH REQUIREMENT
	PRICES (PER (YEAR,	QUARTER,	(FISCAL YEAR,
	CENT CHANGE, POUNDS	SMITHSONIAN	POUNDS
	YEAR/YEAR)	BILLION) EQUALS 100)	BILLION)
1975	22.1	-1.7	70.4 10
1976	15.9	-L 9	58.5 11.7
L977	12.7	-1 5	56.4 9.5

3. OUTPUT AND INCOME. THE ASSUMED RISE IN WORLD TRADE IS  
EXPECTED TO PROVIDE A STRONG STIMULUS BOTH TO MANUFACTUR-

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STR-04 CEA-01 L-03 H-02 PA-02 PRS-01 FEAE-00 OES-06

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R 071651Z SEP 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 5225

TREASURY DEPT WASHDC

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY DUBLIN

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

AMCONSUL BELFAST

AMCONSUL EDINBURGH

USMISSION EC BRUSSELS

USMISSION OECD PARIS

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ING OUTPUT AND INVESTMENT. IMPORT VOLUME WILL BE CONTAINED BY TIGHTER INVENTORY CONTROL AND WEAK CONSUMER DEMAND STEMMING FROM REDUCED REAL DISPOSABLE INCOME. BETWEEN THE FOURTH QUARTERS OF THE 1975 AND 1976 REAL GDP IS EXPECTED TO RISE BY 4.8 PERCENT WITH EXPORTS AND INVENTORIES CONTRIBUTING MOST OF THE IMPETUS. REAL PERSONAL DISPOSABLE INCOME IS EXPECTED TO DROP BY 1.4 PERCENT DURING THE SAME PERIOD BUT A 2.9 PERCENTAGE POINT DE-  
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CLINE IN THE SAVINGS RATIO (14.2 TO 11.3 PERCENT) SHOULD PERMIT REAL CONSUMER EXPENDITURE RISE BY 2.0 PERCENT. THEREAFTER THE RATE OF GDP GROWTH IS EXPECTED TO BE HALVED. OVER THE FOUR QUARTERS THROUGH 1977/4 DECLINES IN CONSUMER SPENDING, GOVERNMENT CAPITAL SPENDING AND TMD PEAKING OF NORTH SEA OIL INVESTMENT WILL REDUCE THE RATE OF REAL GROWTH TO 2.1 PERCENT.

4. INVESTMENT. PARADOXICALLY, NIESR FORECASTS A DECLINE OF 1.7 PERCENT IN TOTAL FIXED INVESTMENT BETWEEN 1976/4 AND 1977/4. THIS, DESPITE AN EXPECTED RISE OF 17.9 PERCENT IN MANUFACTURING INVESTMENT OVER THE SAME PERIOD. DECLINES OF 14.3 PERCENT IN NEW PUBLIC HOUSING, 13.0 PERCENT IN NATIONALIZED INDUSTRY INVESTMENT AND 6.1 PERCENT IN MINING AND QUARRYING (AS NORTH SEA OIL INVESTMENT PASSES ITS PEAK) MORE THAN OFFSET THE RISE IN MANUFACTURING. HOWEVER, A STRONG INVENTORY ACCUMULATION IN 1977 RESULTS IN A POSITIVE CONTRIBUTION BY TOTAL INVESTMENT TO GDP GROWTH OVER THE PERIOD.

5. GOVERNMENT. THE NIESR FORECAST TAKES THE CHANCELLOR AT HIS WORD AND ASSUMES NO FURTHER CHANGES IN PUBLIC SPENDING BEYOND THOSE ANNOUNCED IN JULY. IT ASSUMES THAT THE GOVERNMENT WILL HAVE TO ENFORCE CASH LIMITS ON SPENDING PROGRAMS SINCE ACTUAL INFLATION WILL EXCEED THE 7 PERCENT ALLOWED FOR CALENDAR 1977. AS A RESULT, NIESR EXPECTS THE VOLUME OF PUBLIC SPENDING TO REMAIN FLAT IN 1977 AND DECLINE BY 0.7 PERCENT BETWEEN 1976/4 AND 1977/4.

6. PUBLIC SECTOR BORROWING REQUIREMENT. NIESR ANTICIPATES A PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) FOR FY 1976/77 OF 11.5 BILLION POUNDS. THIS TRANSLATES INTO A CY 76 TOTAL OF 11.7 BILLION POUNDS FOLLOWED BY A DECLINE TO 9.5 BILLION IN CY 1977 AND MEANS THAT THE PSBR

WILL HAVE DECLINED FROM 11.4 PERCENT OF CURRENT GDP IN  
CY 1975 TO 7.7 PERCENT IN CY 1977.

7. MONEY SUPPLY. M3 IS EXPECTED TO RISE BY 10.0 PERCENT  
IN 1976 AND 10.9 PERCENT IN 1977. THIS GROWTH RATE IS  
BASED ON THE ASSUMPTION THAT INTEREST RATES WILL BE PER-  
MITTED TO RISE ,RATHER SUBSTANTIALLY OVER THE FORECAST  
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PERIOD TO MAINTAIN THE CURRENT US.UK DIFFERENTIAL. IN  
FACT, SINCE IT EXPECTS A RISE IN THE US TREASURY BILL RATE  
TO 8.5 PERCENT BY THE END OF 1977, NIESR BELIEVES THAT  
THE UK TREASURY BILL RATE WILL HAVE TO RISE TO 14.0 PER-  
CENT BY THEN. THE CURRENT TREASURY BILL RATE IS 10.9 PER-  
CENT. IT IS FELT THAT NET OF FOREIGN BORROWING, IT  
SHOULD BE POSSIBLE LARGELY TO FINANCE THE PSBR THROUGH  
SALES OF GOVERNMENT DEBT TO THE NON-BANK PUBLIC.

8. BALANCE OF PAYMENTS. NIESR EXPECTS A CURRENT ACCOUNT  
DEFICIT OF 1.9 BILLION POUNDS IN 1976 NARROWING TO 1.5  
BILLION IN 1977. STERLING HAS ALREADY DEPRECIATED NEARLY  
AS FAR AS NIESR HAD PROJECTED FOR ALL OF 1977. ITS TRADE  
WEIGHTED DEPRECIATION IS EXPECTED TO STABILIZE AT 43.6

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ACTION EUR-12

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R 071651Z SEP 76  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC 5226  
TREASURY DEPT WASHDC  
INFO AMEMBASSY BONN  
AMEMBASSY BRUSSELS  
AMEMBASSY DUBLIN  
AMEMBASSY PARIS  
AMEMBASSY ROME  
AMEMBASSY TOKYO  
AMCONSUL BELFAST  
AMCONSUL EDINBURGH  
USMISSION EC BRUSSELS  
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PERCENT DURING THE SECOND HALF OF 1977. AS A RESULT, NIESR PROJECTS THAT THE CURRENT ACCOUNT WILL MOVE TOWARD EQUILIBRIUM BY THE END OF 1977. EXPORT VOLUME IS EXPECTED TO RISE BY 8.9 PERCENT BETWEEN 1975/4 AND 1976/4 AND BY 6.6 PERCENT OVER THE FOLLOWING FOUR QUARTERS. THE CORRESPONDING IMPORT VOLUME FIGURES ARE 4.4 AND 1.7 PERCENT, RESPECTIVELY.

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9. EMPLOYMENT. WITH THE FORECAST SLOWDOWN IN THE OVERALL RATE GROWTH IN 1977, NIESR BELIEVES THAT LITTLE PROGRESS CAN BE MADE IN REDUCING UNEMPLOYMENT FROM ITS PRESENT LEVEL OF 1.3 MILLION (S.A.). WITH MUCH OF THE INCREASE IN OUTPUT CENTERED IN MANUFACTURING WHERE THERE IS ROOM FOR CONSIDERABLE PRODUCTIVITY GAINS, NIESR BELIEVES IT IS UNLIKELY THAT THE UPTURN WILL PRODUCE A BURST OF NEW HIRING. INCREASING PUBLIC SECTOR EMPLOYMENT IS NOT A VIABLE ALTERNATIVE GIVEN THE CURRENT POLICY OF HOLDING THE LINE ON PUBLIC SPENDING. THEREFORE NIESR SEES LITTLE HOPE OF REDUCING UNEMPLOYMENT BELOW 1.2 MILLION BY THE END OF 1977.

10. PRICES. RETAIL PRICE INFLATION IS EXPECTED TO AVERAGE 15.9 PERCENT IN 1976 AND 12.7 PERCENT IN 1977 WITH THE RATE DECLINING TO 10.6 PERCENT BETWEEN 1976/4 AND 1977/4. NIESR BELIEVES THAT ON A QUARTERLY BASIS THE ANNUALIZED RATE OF INFLATION COULD BE IN THE 8 PERCENT RANGE BY YEAR-END. THESE FIGURES ARE BASED ON A 9 PERCENT AVERAGE EARNINGS ASSUMPTION WITH NO WAGE EXPLOSION WHEN THE

CURRENT YEAR OF INCOMES POLICY EXPIRES PLUS NO MAJOR IN-  
CREASES IN WORLD COMMODITY PRICES.

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## Message Attributes

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**To:** STATE  
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**Type:** TE  
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